

## Pre-Council Meeting

### Annexation Agreements April 3, 2006

Meeting Began at: 10:38 a.m.

Meeting Ended at: 11:23 a.m.

City Council Members Present: Ken Svoboda, Robin Eschliman, Jonathan Cook, Jon Camp, Patte Newman, Dan Marvin, Annette McRoy.

City Council Members Absent: None

City Staff Present: Public Works & Utilities: Karl Fredrickson, Margaret Remmenga, Steve Masters, Roger Figard, Michaela Hansen; Finance: Don Herz; Law: Rick Peo, Dana Roper; Planning: Marvin Krout, Ray Hill.

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### INTRODUCTION:

Ken Svoboda called the meeting to order stating that before us we have Public Works, Finance, Planning, and Law, and this Pre-Council is in regards to annexation agreements. We are going to begin with Marvin starting out with introductions and then move through his agenda.

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### PRESENTATION:

Marvin Krout stated that there is one annexation item on the agenda for public hearing today. Among the twelve annexation items that have been pending between the Planning Commission and the City Council, this is probably one of the simplest ones. Even this annexation item is raising a couple of questions and that is why we are here, because you will have three annexation items on the agenda next week for public hearing and at least a couple of those are in the more complicated area because they involve the developer loaning money to the City in the terms of payback. Since impact fees have been adopted about three years ago, you have approved sixteen annexations, so there hasn't been a standstill but we have had some of the cases stacking up, so at this point we do have a dozen cases that are on their way in some form or another. We are either negotiating or we have negotiated and we are scheduling these items for your agenda coming up. Impact fees has had an impact on how these negotiations have occurred. The City's lack of financing has also had an impact on these negotiations. We have spent years without making some major investments in infrastructure and now we are paying the price for it in having to struggle somewhat to try to build out with new big trunk lines as fast as we can to try to open up areas in different parts of the City. As you know we have a particular problem with roads, where we have almost no money except for the money that impact fees is bringing in, in order to pay for road improvements out in the perimeter areas. The lawsuit three years ago created a particular complication for the annexations, in that we want to make sure that we had something to replace impact fees if they were going to be going away as a result of a final Supreme Court decision, even though that decision is taking much longer than we thought it would. Seven months now that it has been before the Supreme Court and I'm sure it is a difficult decision for them. The interim proposal is asking the developer to put up a bond equivalent to the amount of impact fees that they would be paying based on the fee schedule at the time of the annexation agreement. Which means the impact fees would keep going up with inflation over time, this would be establishing a frozen period of time, a frozen set of fees, based on what the current fee schedule is today. That was one complication that we had to deal with in interim while impact fees are still being contested. The second issue had to do with developers suggesting that they should have the right to sue the City even though we are entering into a contract. In the past it has been considered a voluntary agreement that we originally accepted it, again thinking that it was going to be a short period of time. This right to sue the City on the issue even if the City was to win on impact fees, on an individual basis they would be able to sue. Third, there has been a question on

when do you establish the impact fee schedule. If someone has been going through a process in the previous year, if they don't get to the Council until 2006, then our position is that we should use the 2006 fee schedule because even that is a break to what incrementally impact fees is going to be over a period of time. The financial issue is that the developers were wanting to open up land faster than the City's Capital Improvement Program shows that we can provide the infrastructure has left us with the question of developers loaning money to the City for a period of time. We're in basic agreement about trying to make that work, but it does raise all kinds of questions that we have had to discuss with various parties about what are the terms of that payback. Are we going to direct the impact fees generated by that development first to that development? Are we going to direct other impact fees from the district to that area? What is the time line for payback? What is the relative certainty that the developer has that he is going to be paid back in a certain amount of time, and should there be interest on that developer loan to the City from the developer who wants to advance out ahead of the CIP? Should there be interest and how should that interest be calculated? All of those issues have made these negotiations somewhat complicated. In one case that is on the agenda for next week, which is Waterford Estates, that was really the very first of these cases of these dozen or so cases that was approved by the Planning Commission and it has been the pilot project for a lot of these questions that have been asked over time. That particular case the applicant had officially requested that we schedule their item before City Council in 2005. That ended up not happening, but because they were first in line and had requested that original hearing, we are suggesting they use the 2005 fee schedule. Everyone else we are talking about would use the 2006. Karl will now talk about infrastructure and some of these issues.

Karl Fredrickson stated that about three years ago when we started the Infrastructure Financing Committee (IFC) and we projected where we would be, we said in 2006 the wheels come off the bus. We are in 2006 and as these annexations outline it shows that we are trying to get a little bit more creative in how we can keep things moving. With this come some issues to which Marvin eluded to the questions on these. First of all, we are looking at directed impact fees. A year ago we put forth a street directed impact fee policy and how we would try to get streets built. Probably instigated by NW 56<sup>th</sup> and West Adams, trying to get an already annexed area street paved. Trying to get the roads out there by directing fees that way. Its grown to a sense that these are now applied to new annexations also, either where the road doesn't exist or its graveled. The new annexations we have expanded that to water and sewer. To direct water and sewer impact fees back to repay the developer's loan to us. They would go ahead and install the infrastructure and we would agree to pay back with the impact fees. If the impact fees are not enough to cover the full loan, the difference we have been calling the increment, the difference between the total cost from what impact fees was projected to cover. That portion would be paid back at a date in the future with interest. We are talking about 2% interest for water, sewer, and streets. That is something we have not done before and have not done yet. In our agreements we have been looking at what does that do and how does it affect our Capital Improvement Program. All of these annexations are in Tier 1A, but they are generally on top of the hill, but when we built sewer we start at the bottom and work our way up. So directing the impact fees back potentially has the consequence of slowing us down on the lower end. Those funds won't be used on the down hill side and work there way up hill. That does have an affect on directing where our CIP goes and the priorities of the City. On a couple of these, back in the IFC, we put forth a Category 5 sewer plan, we would try to get those pipes to those basins, in the year hence identified when the rates started increasing. In order to make some of the dates as specified in the annexation agreements we are looking at more of a market oriented approach. If you are ready to be here, we are going to say then we will take the money that we thought we were going to spend elsewhere and put pipe in where people are ready to go and ready to build, which the annexations before you are. Our bonding ability on water and sewer, we are looking at always using "best efforts" language for the pay back. It gives the City some amount of flexibility in a 'what if' situation should happen, should development grind to a complete halt, should a tornado or something happen where we need to spend our Capital dollars on other things with far more pressing priority. If we use "best efforts" language that gives us a little bit of flexibility, it also from my understanding, its not counted in our cash needed for our bonding ability. We do take our water and sewer rates and we bond them to the extent possible to advance our infrastructure. So if we would have to pay it back date certain, we would have to set aside

what I would call a “sinking fund” and that dollar amount could not be used in bond calculations. So using the language “best efforts” we don’t have to create a sinking fund. The largest question out there is that these are all based on rate increases going into the future. Our capital program is put together based on this Category 5, based up on rate increases and so if rates don’t increase or don’t increase at the rate projected, some of the capital projects we have out there would have to come to a halt in order to make those pay backs. Our street dollars CIP, as we’ve identified through our earlier budget meetings, are projecting our gas tax revenue through the state is decreasing. Our rate is decreasing, we had projected that to increase at 4% per year, we are projecting that to be about only 1% per year now. Our operating and maintenance costs as the City gets bigger, vehicle miles of travel, whatever we have to do with maintenance on streets is increasing, but our rates at which our gas tax revenue used to support those activities are decreasing. We estimated in about year 2013 - 2014 that our O&M costs are going to overtake our state gas tax projections.

Jon Camp: So is that revising from 4% to 1% gains? You said you had projected 4% gains in state gas tax and now its only increasing at 1%?

Karl Fredrickson: That is what we had projected for increase, so we form our operating budgets and what is left over is for capital. So we are not getting as much money as projected in prior years and we are sliding our capital program out over more years.

Jon Camp: The 2013 is now premised on the 1% annual increase?

Marvin Krout: The CIP that we are preparing that you will be seeing shows basically the effects of that are more out beyond the CIP in year 7-12 but it makes even more imperative the search for additional revenue sources for roads if we are going to keep up with the capital demands.

Karl Fredrickson: The other and probably last thing is that in working with these dozen of backlogged agreements in trying to figure a way to move forward and adjusting our capital program accordingly (which has not necessarily occurred yet, this is a proposed program), its coming up with some sort of a policy or framework envelope to operate, what would be acceptable and what wouldn’t. So we have been trying to draft out the ideas of what envelope would be acceptable for the City’s risk, and one of which would at least try to put a time frame at the end of this fiscal year (August 31), a time frame to re-evaluate whether or not any of these terms of these agreements are acceptable to continue on in the future. If we start agreeing to these then at what point does the City not have any cash to do anything anywhere because the dollars are all being paid back. The thought is to put down that the interest would be only on an increment, only on annexations going through this fiscal year we agree to evaluate at the end of the year to see whether to continue this process or do something different. We are trying to get that in writing.

Patte Newman: Are there other communities that do allow cities to pay interest on investments that developers pay? Is this a normal procedure?

Karl Fredrickson: Most cities are different. Maybe Marvin might have more insight into it. I think a lot of cities are probably all different, I couldn’t factually tell if there is a city that does that. There are cities that either put the infrastructure in, there are other cities that don’t put any in, its all developer driven, so anywhere in between is where you will find it across the country.

Patte Newman: So you can’t name any off the top of your head that actually pay interest?

Karl Fredrickson: No, I couldn’t name one.

Marvin Krout: As we have been negotiating it and as it is being proposed and agreed to in the cases where we have talked about it, the interest would be limited as of today to about 2% which is the money that we are making in the bank and it would only be on the portion of the loan that is above and beyond the amount that the impact fees from that development are calculated to bring in. So if the impact fees are going to pay for the road, for example, and in many cases the impact fees will pay at least for the initial two-lane road to get the development going, there will be no interest. If the water and sewer, where there is a lower percentage of the total and there is more City investment going in to it, if the water and sewer, lets say the impact fees were going to pay half of the total amount, the other half would come from water and sewer fees, the interest would be on that other half, not on the total. There is some question about when does that interest start. That may be one of the issues, that following public hearing, will have to be discussed. Should the interest start accruing at the time that the developer takes out the loan or does it start at the time the infrastructure is actually available and ready for services. I have no experience with any city that has paid interest back on loans. What we are trying to do is be fair and consistent and understand that this is not just hard for the City, there are risks here for the City, it is tying up the program, but there are also risks for the developer, he has to go out and borrow money and that is not always easy.

Patte Newman: The point is though, it's a dramatic shift in policy for this City.

Rick Peo: I don't know that it should be classified as a dramatic shift. Maybe we are making a shift in policy, but the impact fee ordinance as written authorizes the use of interest as a reasonable way of reimbursing the developer who pays more than his fair share. The ordinance already allows the use of interest, we just haven't done this in the past. When we drafted the impact fee ordinance we found other jurisdictions had that type of language in there to authorize the use of interest.

Marvin Krout: I think you could say that if we have more capacity and we are able to bond more money, we would be selling bonds at an interest rate that would cost the City more than 2%.

Jonathan Cook: You were mentioning when the interest would kick in and we could consider the point at which we would have constructed the facility based upon our current plan and if they wanted to accelerate ahead of that well that's their deal. However, at the time the project would have been put in the ground, maybe that is when the interest would start. I don't know if you have had discussions about that.

Marvin Krout: Yes, we have had discussions. I guess the bottom line is that we would say to you today that it is important and it is a significant benefit at this time to open up more land so that we can have an affect on the price of land, which I'm sure you've heard before is very high partly because we have a constrained market, which constrains the supply of land that has services so farmers are able to hold out for almost anything that they want. That has probably has had an affect, that price of land, on housing prices and on new construction.

Jonathan Cook: You are not advocating that we delay, your saying that there is a question about when the interest would kick in, but your not suggesting in your discussions that we should wait for it to kick in until that time that we would have constructed the facility if we had been going forward with our plan.

Marvin Krout: No, because then the land supply would become more constrained and be more difficult.

Jonathan Cook: So you are advocating that interest be paid right near the beginning.

Marvin Krout: Right.

Jonathan Cook: There are technical matters about when it starts.

Karl Fredrickson: Our proposal is when it is available for usage, when you can tap it, can put a toilet on it, or the public can drive on it, that is our proposal when interest would start. That can also be phased to, you don't have to have all the development done to have it occur. They could develop in phases as well. On these two annexations, we did have some of these projects in our CIP, they are not in this year, they are like 2-3-4 years down the road. So we wouldn't necessarily hold off, we would make payment in the year that we thought we would build it, since we are intending to build out Tier 1A based upon past CIPs and forecast CIPs. It's just that they are ahead of us by 1-6 years.

Jonathan Cook: You want to pay them within that time?

Karl Fredrickson: On the increment, yes.

Marvin Krout: It is a declining principal too, because they will be getting their impact fees back each year.

Don Herz stated the question is why is there a bond ordinance. In response to that is simply because these annexation agreements require re-payment beyond the four years that you can do through a contractual basis. If it weren't for the four years, you probably wouldn't need the bond ordinance. City Charter limits you to just the four years. If an obligation extends beyond the four years, then the City must create an obligation in the form of a bond, similar to what you do with a GO bond or revenue bond. The major difference between those types of bonds and this is that this is issued to the developer, its called a private placement bond. These bond agreements were put together by our Bond Council and consultation and reviewed by the Law Department, so we think we've addressed the legal issues as far as being able to issue this type of a transaction. Its important to note that the annexation agreement describes the terms of the bond ordinance. Couple of key points, for the two on first reading today it carries a 2% interest rate, I think that was set because at the time when we were looking at an interest rate that was what we were earning on our short term investments and that there is not a specific date of repayment, its "best efforts". The 2% represents approximately 200-300 basis points less than what our cost of borrowing is. It benefits the developer because it allows the projects to move forward sooner than later, so I think there is a benefit for both parties in that respect. The question is how will the payment be funded. Since we are just looking at this for the first time, as I would expect that once these projects would get into our 6-year CIP, the City will have to assess if bonds will need to be set aside each year to pay this future obligation or if it might be possible to simply repay the obligation with accumulated fund balance at that time. Its important to be able to do either of those because we will not be able to issue new bonds to repay these, in other words you can't issue a series of tax exempt revenue bonds to repay these obligations. They would have to be paid by either setting aside funds over a period of years or in the year they become due, have accumulated resources. Just a cautionary note, these types of transactions will continue to put pressure on ensuring that we approve future utility rate increases and secure additional street funding.

Dan Marvin: You would set aside funds for like a reserve account to repay some future obligation five to ten years from now. Is that what you are saying?

Don Herz: That would be one option.

Dan Marvin: What would be the other one?

Don Herz: If the amounts aren't material and typically when we are paying for major capital improvements, a portion of them are paid with accumulative fund balances and portion paid with new revenue bonds.

Dan Marvin: Let's say its millions of dollars.

Don Herz: Then I think it would be prudent that you would start reserving some money.

Dan Marvin: The other option, aside of reserving, would be just from that years cash flow.

Don Herz: Correct. I think it is important to know that you just couldn't roll that into a revenue bond obligation because the City can not issue bonds to pay for capital improvement that is already received.

Dan Marvin: The Water and Sewer Department couldn't do that then. If you were front loading water and sewer lines this way, what you are saying is that you couldn't issue a water and sewer bond to repay that because it is already in the ground, its been in for five or six years. You wouldn't be able to repay that one?

Don Herz: That's right.

Karl Fredrickson: Three years ago we went to a cash flow CIP. Projects that are put in that year's CIP are intended to be under way during that CIP, we are not setting aside cash. The only time we have a large cash balance is right after we issue a bond.

Dan Marvin: So if we are going to start reserving now, whatever that amount might be, that's going to take money away from your CIP projects.

Karl Fredrickson: In practice it would, yes. But if we use the "best efforts" language, my understanding is that it wouldn't reduce our cash to issue debt. If we use the "best efforts" language then we would have to take that cash away from our calculations on how much we could bond for.

Dan Marvin: But even with the "best efforts" language in there, it seems to me that you are going to have to start reserving money to pay this future obligation, which begs to question are we gaining anything by having somebody front load at the front end, but we are going to have to be reserving cash annually to pay it back. I suppose you gain a little something.

Don Herz: You gain because of the cost of borrowing over ten years.

Karl Fredrickson: The water and sewer asset should be fifty plus years, if not seventy-five plus years, in life span. So the interest rate is lower than what you can bond for in revenue. That's a pretty inexpensive rate for a long term asset.

Marvin Krout: Not that Rick hasn't been involved in all of these issues extensively, but I think one particular issue that you may have heard about the last week is this provision that we had previously accepted and are recommending that you not include in future agreements, which we refer to as the right to sue provision.

Rick Peo: One of the conditions in the annexation agreements is to provide a fail safe mechanism for the City of Lincoln, so that if the impact fee ordinance is declared invalid and we can't collect impact fees we can still bring funds into the City through annexation. We put in those annexation agreements an obligation that if the impact fee ordinance was declared invalid then the developer would pay a contribution in an equivalent amount based on the year that he entered into that annexation agreement. That process went well for the early annexations, but along the way some of the developers began to object to that provision claiming that the contribution that the City was imposing, if the impact fee ordinance was invalid, would likewise be deemed invalid as it would not be roughly proportional to the impact their development was causing. We reached an impasse where people weren't going to sign the annexation agreements. It appeared to be a stalemate and development wouldn't occur. A compromise

proposal was offered where we would allow them to reserve the right to sue on the annexation agreement, if the impact fee ordinance should be declared invalid. In return, they gave up the right to bring what we call a 1983 lawsuit against the City and Council members, claiming that the action of the City in denying their development, denying their annexation, was a violation of their due process rights. At the time that seemed like a reasonable compromise, but several years have gone by now, the lawsuit at the District Court level took longer than we anticipated, the decision on appeal is taking longer than what we might have thought, and the City's really getting to the point of having a lot of dollars at risk. Outstanding annexations contribution are several million dollars, around ten or more; but we have six annexations coming forward probably within the next couple of months that total up to about 22 million dollars for the contribution amounts. Looking at those types of dollars it was kind of like maybe the risk is greater than its worth. So were proposing that we go back and tell the developers, if you really want to be annexed then you have to say this is going to be a voluntary agreement on part. We're willing to put in our fair share, pay that amount if impact fee ordinance goes away. If not, we don't have a mutually agreed agreement between us and the City and we don't get annexed. On the other hand, we would again be exposed to a lawsuit that if they didn't sign that agreement, we didn't annex them, we didn't give them the change of zone, then that's an arbitrary and capricious, denial of their due process rights. I think that is less of a risk, because that would be a factual determination based on their individual annexations as opposed to the right to sue, one person wins, everybody wins. That is if one person brings a lawsuit and they win, then other developers get the benefit of that clause. I should point out that under a 1983 lawsuit, it is not only potentially the City who would be liable, but individual Council members could be named individually and held liable if you are deemed to be responsible for denying that due process.

Dan Marvin: This job keeps getting better and better.

Rick Peo: The case that we had in the City a few years ago was a 1983 lawsuit, that the City lost and had to pay attorney fees plus the damages, it was not brought against each individual Council members, only the City. The difference between that case and the one we are talking about today is that was a down zoning to deny a person the right to build on what was presently legal. This is the reverse, people are asking to be up zoned or to be asked to be brought into the City limits. I think those are discretionary activities. The City is not denying them something that they have the right to do today, they are asking to do something that they can't do. So I think that the circumstances are different. The liability under the 1983 lawsuit is limited, again case by case. If we had a situation which we felt could jeopardize the City, then they would get special treatment.

Marvin Krout: I guess we could answer questions. I just wanted to make sure that you knew the complications with some of these agreements.

Jon Camp: Rick, you mentioned some of the legal changes in these documents due to contractual litigation of appeal. Aren't we really close to having this resolved?

Rick Peo: We thought that a couple months ago. I think we are really close. It is just that the timing of some of these developments coming through are pretty big dollars. Take Waterford, Southwood Lutheran, some of those, we are going to need maybe 5 million within the next couple of weeks. Even if we got sued on the ordinance itself, and impact fees were declared invalid, I think we still have a legitimate argument that those are still contractual arrangements and they would still be valid.

Marvin Krout: Also Rick has advised us that it seems like a more probability that the decision from the Supreme Court may not be clearly yes and clearly no and so we could be in sort of a limbo for an extended period beyond their decision.



Jon Camp: We have gone along with this for a couple years. Shifting gears almost makes it look like, did we make a mistake the first time around, does that open the door to those annexation agreements?

Rick Peo: It was introduced as a compromise with developers to try to keep growth going in Lincoln and not to try to reach a stalemate. We gone through the big commercial developments that already come in, we were looking primarily at more smaller commercial, residential. Again, right now we are coming in with another grouping of fairly large commercial type developments that bring in big dollars. It looked like things were going to fast, we were exposing our self to a lot more risk financially.

Robin Eschliman: From hearing this it sounds like this is innovative. You are coming up with some creative ideas that perhaps no other City has in common. You are still thinking about the implications to the bond. I applaud you for being creative and for trying to find a solution. I would assume that some of those developers have probably approached a bank and asked for a loan of money or what it would cost to loan the money, so they can loan you for the sewer and water. Is there a difference in spread between, they are getting 2% from you, what is their bank charging them? Have you heard?

Don Herz: The question is what is their cost of capital. That is going to vary from business to business, whether or not they need to borrow the money or they need to come up with some other sources, its their cost of capital. I assume their cost of capital is going to be more than the 2% that we have. That will vary from developer to developer.

Robin Eschliman: In regards to the lawsuit, basically what you are saying is that they have the right to sue us now and we are asking them to give that right up. I forget what kind of lawsuit this falls under, but how is that different than say a personnel issue where you are hiring City personnel and you don't want the City to be sued and so you ask them to sign some waiver that they won't ever sue you for discrimination or something like that? If you have a constitutional right for something, is this really any different than that?

Rick Peo: You can voluntarily agree to certain things if both sides have consideration. That it is a binding contract and you can't come back to claim it was invalid because it was entered unto in duress and therefore its not binding on me and I don't have to abide by my agreement. The City is making commitments as part of this agreement. We are annexing the property, we are giving them the change of zone so they can develop which enhances their property values. We are agreeing that we are going to provide certain type of infrastructure, they are now going to have City water and sewer, they are going to have City public streets. In return we are asking them to bare their fair share of our cost to do that. If we are going to bring you in to the City, we don't want to fund 100%, we except you to pay a portion of your impact. If we do all of our activities and then they turn around and say sorry City I'm not happy with the deal I stuck I now want to sue you, then the way the agreement is written today it's a weaker argument for the City to claim that they entered into a voluntary agreement. It appears to be they are trying to say I'm still reserving the right to claim duress. Maybe they will just claim the right to say its not proportionate, but I still might owe something. Those are the risks the City has as to whether or not we are going to get any money back. We brought in developments, we pay a million dollars expecting impact fees. If those go away and if the obligation under the annexation agreement goes away, then the City has to absorb those dollars.

Dan Marvin: I would like to take the time here to reiterate my request that we have a Pre-Council on the water and sewer rate increases. Before they come to us, that we have some kind of laid out plan that talks about what those rate increases are, not just for 2006 but for out years. I think that's important if we are going to try and sell this to the public, what I heard was a 9% rate increase coming this year, this is a steep rate increase and if we are going to do that then we need to be able to tell them this is what the projected plan is, get some money in that way, and be able to show out year numbers as well.



Ken Svoboda: Will all of you be available this afternoon for the public hearing since this topic will come up obviously during the annexation agreement for public hearing this afternoon? Rick, I'm certain you will be there.

Rick Peo: Yes.

Ken Svoboda: Probably, not Don. I wouldn't imagine we would not going to have bonding questions.

Don Herz: I think the public hearing on these will be next week.

Ken Svoboda: On some of these.

Marvin Krout: We have one item that doesn't have a bond ordinance on the re-payment.

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**CLOSING:**

Ken Svoboda closed the meeting by thanking everyone for the presentation.

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Prepared By: Chris Koll, Public Works & Utilities